

STERLING

MULTIFAMILY TRUST

RISK FACTORS

Risks Related to Sterling Multifamily Trust

Common shares of beneficial interest represent an investment in equity only, and not a direct investment in our assets. Therefore, common shareholders will hold only an indirect interest in our assets.

The common shares of beneficial interest represent an equity interest only in us, not in any of our assets or the real estate or real estate related investments made by our operating partnership. We will have no substantial assets other than our equity interest in the operating partnership. Neither the Advisor nor any of its managers or affiliates has any obligation with respect to the payment of dividends to our shareholders or the return of capital investments made to us by the shareholders.

Income will be received primarily from the leasing and resale of investments, which is subject to market and economic changes. If income is insufficient to meet our capital needs, our ability to carry out our business plans could be adversely affected.

Our purpose is to acquire and hold our real estate investments as long-term investments before we resell the investments to maximize anticipated appreciation for our shareholders. The primary income that will be generated by us will be the profits, if any, from the operation or holding of the real estate and real estate related investments and upon the resale of the investments. If circumstances arise which cause an investment to remain at its current value or decrease in value, we may generate less income than anticipated.

We may raise additional funds in the future to fund our capital needs, which may not be available on acceptable terms if at all.

We may need to raise additional capital in the future in order to fulfill our business plans. The timing and amount of our future capital needs will depend on a number of factors, including the revenue generated by the operation of our real estate investments, when and if the properties will appreciate in value, the resale price of the properties and other real estate related investments, our future operating expenses and required capital outlays. There can be no assurance additional financing will be available when needed on terms favorable to us, if at all.

Further, we may be required to raise additional capital and sell additional securities in the future on terms which are more favorable to those investors than the terms under which our current shareholders purchased their common shares. If adequate funds are not available or are not available on acceptable terms, our ability to fund our current business plans and to acquire additional real estate and real estate related investments would be significantly limited. Such limitation could have a material adverse effect on our results.

Our success is based on continuing to locate and hold suitable real estate investments, and failure of our Advisor to locate additional suitable properties or the unsuccessful operation of our existing real estate investments could adversely affect our operations and our ability to pay dividends.

Our ability to achieve our investment objectives and to pay dividends to our shareholders is dependent upon the performance of our Advisor in locating suitable investments and appropriate financing arrangements for us as well as on the successful management of our properties after acquisition. We currently own, through the operating partnership, the properties described under Item 2 – Properties.

We cannot be sure our Advisor will be successful in continuing to obtain suitable investments on financially attractive terms, or be certain that operation of the properties will avoid the risks attendant to real estate acquisitions, such as:

- The risk properties may not perform in accordance with expectations, including projected occupancy and rental rates;
- The risk we may have underestimated the cost of improvements required to bring an acquired property up to standards established for its intended use or its intended market position.

Our Board of Trustees may have to make expedited decisions on whether to invest in certain properties or real estate-related assets, including prior to receipt of detailed information on the investment.

In the current real estate market, our Board of Trustees may frequently be required to make expedited decisions in order to effectively compete for the acquisition of desirable properties and other real estate-related assets. In such cases, our Advisor and Board of Trustees may not have access to detailed information regarding investment properties, such as physical characteristics, environmental matters, zoning regulations or other local conditions affecting the investment property, at the time of making an investment decision to pay a non-refundable deposit and to proceed with an acquisition. In addition, the actual time period during which our Advisor will be allowed to conduct due diligence may be limited. Therefore, there can be no assurance our Advisor and Board of Trustees will have knowledge of all circumstances that may adversely affect an investment.

We face competition from other real estate investors for suitable properties, and may not be successful in our attempts to acquire desirable properties.

The commercial and multi-family real estate industries are highly competitive, and we face competition for investment opportunities. These competitors may be real estate developers, real estate financing entities, real estate investment trusts, mutual funds, hedge funds, investment banking firms, institutional investors and other entities or investors that acquire real estate and may have substantially greater financial resources than we do. These entities or investors may be able to accept more risk than our Board of Trustees believes is in our best interests. This competition may limit the number of suitable investment opportunities offered to us. This competition also may increase the bargaining power of property owners seeking to sell to us, making it more difficult for us to acquire properties or interests in properties. In addition, we believe competition from entities organized for purposes similar to ours may increase in the future.

We may change our investment and operational policies without shareholder consent, and such changes could increase our exposure to additional risks.

Generally, the Board of Trustees may change our investment and operational policies, including our policies with respect to investments, acquisitions, growth, operations, indebtedness, capitalization and distributions, at any time without the consent of our shareholders, which could result in our making investments different from, and possibly riskier than, investments made in the past. A change in our investment policies may, among other things, increase our exposure to interest rate risk, default risk and commercial real estate market fluctuations, all of which could materially affect our ability to achieve our investment objectives.

There can be no assurance dividends will be paid or increase over time.

There are many factors that can affect the availability and timing of cash dividends to our shareholders. Dividends will be based principally on cash available from our real estate and real estate related investments. The amount of cash available for dividends will be affected by many factors, such as our ability to acquire profitable real estate investments and successfully manage our real estate properties and our operating expenses. We can give no assurance we will be able to pay or maintain dividends or that dividends will increase over time. Our actual results may differ significantly from the assumptions used by our Board of Trustees in establishing the dividend rate to our shareholders.

We may pay dividends from sources other than our cash flow from operations, which could subject us to additional risks.

We are permitted to pay distributions from any source. If we fund dividends from cash flow from operations or working capital, we will have less funds available for investment in real estate and real estate related investments and our shareholders' overall return may be reduced. Actual cash available for dividends may vary substantially from the estimates of our Board of Trustees. Because we may receive income from interest or rents at various times during our fiscal year, dividends paid may not reflect our income earned in that particular dividend period. In these instances, we may obtain third party financing to fund our dividends, causing us to incur additional interest expense. We may also fund such dividends from the sale of assets or additional securities. Any of these actions could potentially negatively affect future results of operations.

Dividends may include a return of capital, and shareholders may be required to recognize capital gain on distributions.

Dividends payable to shareholders may include a return of capital. To the extent dividends exceed cash flow from operations, a shareholder's basis in our shares will be reduced and, to the extent dividends exceed a shareholder's basis, the shareholder may recognize capital gain and be required to make tax payments.

We depend on certain executive officers and trustees, and the loss of such persons may delay or hinder our ability to carry out our investment strategies.

Our future success substantially depends on the active participation of James Wieland, one of our trustees, Kenneth Regan, our Chief Executive Officer and a trustee, and Bradley J. Swenson, our President. Messrs. Wieland and Regan are also governors and owners of the Advisor; and Mr. Swenson is also the President and a governor of the Advisor. Messrs. Wieland and Regan have over 30 years of extensive experience each in the commercial real estate industry, and have been instrumental in setting our strategic direction, operating our business and arranging necessary financing, and through the Advisor, in locating desirable real estate investments and where serving as property manager, managing our properties. Losing the services of Messrs. Wieland, Regan, or Swenson could have a material adverse effect on our ability to successfully carry out our investment strategies and achieve our investment objectives. There can be no guarantee they will remain affiliated with us.

Our systems may not be adequate to support our growth, and our failure to successfully oversee our portfolio of real estate investments could adversely affect our results of operation.

There can be no assurance we will be able to adapt our management, administrative, accounting and operational systems, or hire and retain sufficient staff, to support any growth we may experience. Our failure to successfully oversee our current and future real estate investments or developments could have a material adverse effect on our results of operation and financial condition and our ability to pay dividends to our shareholders.

Risks Related to Our Structure

There are limitations on ownership of our common shares of beneficial interest, which could discourage a takeover transaction even if it is beneficial to our shareholders.

Our Amended Declaration of Trust provides no person may own more than 9.9% of our outstanding common shares of beneficial interest. Even if a shareholder did not acquire more than 9.9% of our shares, the shareholder may become subject to such restrictions if redemptions by other shareholders cause the holdings to exceed 9.9% of our outstanding shares. This limitation may have the effect of delaying, deferring or preventing a transaction or a change in control of us, including an extraordinary transaction (such as a merger, tender offer or sale of all or substantially all of our assets) that might provide a premium price for our shareholders, even if it would be in the best interest of our shareholders. The ownership limits and restrictions on transferability will continue to apply until our Board of Trustees determines it is no longer in our best interest to continue to qualify or seek to qualify as a REIT.

Our shareholders may experience dilution if we or our operating partnership issues additional securities.

Our shareholders do not have preemptive rights to any shares issued by us in the future. If we sell additional shares in the future to raise capital, issue additional shares pursuant to a dividend reinvestment plan or issue shares in exchange for limited partnership units pursuant to our exchange rights under the LLLP Agreement of our operating partnership, our shareholders will experience dilution of their equity investment in us. In addition, if our operating partnership sells additional securities or issues additional securities in connection with a property acquisition transaction, we would, and indirectly our shareholders would, experience dilution in its equity position in the operating partnership.

Our shareholders have limited control over our operation, and the Board of Trustees has the sole power to appoint and terminate the Advisor.

Our Board of Trustees has the sole authority to determine our major policies, including our policies regarding financing, growth, investment strategies, debt capitalization, REIT qualification, distribution, and to take certain actions including acquiring or disposing of real estate and real estate related investments, dividend declaration and the election or removal of the Advisor. Our shareholders do not have the right to remove the Advisor, but have the right to elect and remove trustees. Under the Amended Declaration of Trust, our trustees may not do the following without the approval of the holders of a majority of the outstanding common shares of beneficial interest:

- Amend the Amended Declaration of Trust, except for amendments which do not adversely affect the rights, preference and privileges of shareholders;
- Sell all or substantially all of our assets other than in the ordinary course of business or in connection with a liquidation and dissolution;
- Conduct a merger or other reorganization of the trust; or
- Dissolve or liquidate us.

In addition, the shareholders have the right, without the concurrence of the Board of Trustees, to terminate the trust and liquidate our assets or amend the Amended Declaration of Trust.

Shareholders have no role in determining our investments and must rely on our Advisor and oversight by the Board of Trustees.

For future acquisitions identified by our Advisor, the Board of Trustees has the authority to approve such investment acquisitions without shareholder approval. Therefore, shareholders will not be able to evaluate the terms of future investment acquisitions, their economic merit or other relevant financial data before we acquire such investments. The shareholders must rely entirely on the oversight of our Board of Trustees, the management ability of our Advisor and the performance of the property managers.

We may issue common shares of beneficial interest with more favorable terms than the outstanding shares without shareholder approval.

Under our Amended Declaration of Trust, our Board of Trustees has the authority to establish more than one class or series of shares and to fix the relative preferences and rights regarding conversion, voting powers, restrictions, limitations as to dividends and other distributions, and terms or conditions of redemption of such different classes or series without shareholder approval. Thus, our Board could authorize the issuance of a class or series of shares with terms and conditions that could have priority as to dividends and amounts payable upon liquidation over the rights of the holders of our outstanding common shares of beneficial interest. Such class or series of shares could also have the effect of delaying, deferring or preventing a change in control of us, including an extraordinary transaction (such as a merger, tender offer or sale of all or substantially all of our assets) that might otherwise provide a premium price to holders of our shares, even if it would be in the best interest of our shareholders.

Shareholders could incur current tax liability on dividends they elect to reinvest in our shares, and may have to use separate funds to pay their tax liability

Shareholders that participate in our dividend reinvestment plan will be deemed to have received, and for income tax purposes will be taxed on, the amount reinvested in shares to the extent the amount reinvested was not a tax-free return of capital. In addition, our shareholders will be treated for tax purposes as having received an additional dividend to the extent the shares are purchased at a discount to fair market value. As a result, unless shareholders are a tax-exempt entity, they may have to use funds from other sources to pay their tax liability on the value of the shares received.

Our trustees, officers, Advisor and its affiliates have limited liability to us and our shareholders, and may have the right to be indemnified under certain conditions.

Our Amended Declaration of Trust provides that our trustees, officers, Advisor and its affiliates will not be held liable for any loss or liability suffered by us if: (1) the trustee, officer, Advisor or its affiliate determines in good faith its actions or inactions were in our best interest, (2) such actions were taken on behalf of us and (3) such liability or loss was not the result of: (a) negligence or misconduct by a trustee (other than an independent trustee), the Advisor or its affiliate or (b) gross negligence or willful misconduct by an independent trustee. Moreover, we are required to indemnify our trustees, officers, the Advisor and its affiliates, subject to limitations stated in the Amended Declaration of Trust. As a result, we and our shareholders have limited rights against our trustees, officers, the Advisor and its affiliates, which could reduce our and our shareholders' recovery from these persons. In addition, we may be obligated to fund the defense costs incurred by such parties in some cases, which would decrease the cash otherwise available for dividends to our shareholders.

There may be conflicts of interest between us and our shareholders on one side and our operating partnership and its limited partners on the other side.

Our trustees and officers have duties to us and our shareholders in connection with their management of us. At the same time, we, as general partner will have fiduciary duties to our operating partnership and its limited partners in connection with the management of the operating partnership. Our duties as general partner of the operating partnership may come into conflict with the duties of our trustees and officers to us and our shareholders. The LLLP Agreement of our operating partnership expressly limits our liability for monetary damages by providing we will not be liable for losses sustained, liabilities incurred or benefits not derived if we acted in good faith. In addition, our operating partnership is required to indemnify us and our trustees and officers from and against any and all claims arising from operations of our operating partnership, unless it is established: (1) the act or omission was material and committed in bad faith or was the result of active and deliberate dishonesty; (2) the indemnified party received an improper personal benefit in money, property or services; or (3) in the case of a criminal proceeding, the indemnified person had reasonable cause to believe the act or omission was unlawful. The LLLP Agreement also provides that we will not be held responsible for any misconduct or negligence on the part of any agent appointed by us in good faith.

If we are deemed to be an investment company under the Investment Company Act, our shareholders' investment return may be reduced.

We are not registered as an investment company under the Investment Company Act of 1940, as amended ("Investment Company Act") based on exceptions we believe are available to us. If we were obligated to register as an investment company, we would have to comply with a variety of substantive requirements under the Investment Company Act. Registration as an investment company would be costly, would subject us to a host of complex regulations, and would divert the attention of management from the conduct of our business. If the SEC or a court of competent jurisdiction were to find we are required, but in violation of the Investment Company Act had failed, to register as an investment company, possible consequences include, but are not limited to, the following: (i) the SEC could apply to a district court to enjoin the violation; (ii) our shareholders could sue us and recover any damages caused by the violation; (iii) any contract to which we are party made in, or whose performance involves a violation of the Investment Company Act would be unenforceable by any party to the contract unless a court were to find that under the circumstances enforcement would produce a more equitable result than non-enforcement and would not be inconsistent with the purposes of the Investment Company Act; and (iv) criminal and civil actions could be brought against us. Should we be subjected to any or all of the foregoing, we would be materially and adversely affected.

There is no public trading market for our shares, nor do we expect one to develop, which may negatively impact a shareholders ability to sell their shares and the price at which shares may be sold.

There is no public market for the shares and no assurance one may develop. In addition, the price shareholders may receive for the sale of their shares is likely to be less than the proportionate value of our investments. If our shareholders are able to find a buyer for their shares, they may have to sell them at a substantial discount from the price they purchased the shares. Consequently, shareholders may not be able to liquidate their investments in the

event of emergency or for any other reason. Therefore, shareholders should consider our securities as illiquid and a long-term investment and should be prepared to hold their shares for an indefinite period of time.

The estimated value of our common stock is based on a number of assumptions and estimates that may not be accurate and is also subject to a number of limitations.

The current estimated value of our common stock equals \$16.00 per share. The methodology used by our board to determine this value was based on estimates of the value of our real estate investments, cash and other assets and debt and other liabilities as of a date certain and no subsequent valuation has been undertaken by us. The valuation process involves a number of estimates, assumptions and subjective judgments that may not be accurate and complete. Further, different parties using different assumptions and estimates could derive a different estimated value per share, which could be significantly different from our estimated value per share. The estimated value per share may not represent current market values or fair values as determined in accordance with U.S. generally accepted accounting principles. The estimated value of our real estate assets used in the analysis may not necessarily represent the value we would receive or accept if the assets were marketed for sale. Further, acquisitions and dispositions of properties will have an effect on the value of our estimated price per share, which is not reflected in the current estimated price. Moreover, the estimated per share value of the common stock does not reflect a liquidity discount for the fact that the shares are not currently traded on a public market, a discount for the non-assumability or prepayment obligations associated with certain loans and other costs that may be incurred in connection with the sale of assets. As a result a shareholder should not rely on the estimated value per share as being an accurate measure of the then-current value of the shares of our common stock in making a decision to buy or sell shares of our common stock, including whether to reinvest dividends by participating in the dividend reinvestment plan and whether to request redemption pursuant to our share redemption program.

Shareholders may not be able to have their shares redeemed under the Share Redemption Plan, and if shareholders do redeem their shares, they will not receive the current value of the shares.

We have adopted a share redemption plan. However, our Board of Trustees can limit, suspend, terminate or amend the plan at any time without shareholder approval, and there is no assurance we will have sufficient funds available at the time of any request to honor a redemption request for cash. Shares redeemed under this plan may be purchased at a discount to the current price of the shares or to the price paid for such shares by the shareholder. Therefore, shareholders may not receive the amount they paid for the shares and may receive less by selling their shares back to us than they would receive if they were to sell their shares to other buyers.

There will be transfer restrictions on the shares, and we do not plan to register the shares for resale.

Other than shares issued under our dividend reinvestment plan, we have not registered our shares under federal or state securities laws, but rather we have sold the shares in reliance on exemptions under applicable federal and state securities laws. Therefore, the shares may be “restricted securities” and may not be resold unless they are subsequently registered under the Securities Act and applicable state securities laws or pursuant to exemption from such registration requirements or may have other transfer restrictions based on the exemption relied on for the sale of the shares. We are not obligated to, nor do we currently plan to, register any shares for resale.

Risks Related to Our Status as a REIT and Related Federal Income Tax Matters

If we fail to continue to qualify as a REIT, we would incur additional tax liabilities that would adversely affect our operations and our ability to make distributions and could result in a number of other negative consequences.

Although our management believes we are organized, have operated, and will be able to continue to be organized and to operate in such a manner to qualify as a real estate investment trust (REIT), as that term is defined under the Internal Revenue Code, we may not have been organized, may not have operated, or may not be able to continue to be organized or to operate in a manner to have qualified or remain qualified as a REIT. Qualification as a REIT involves the application of highly technical and complex Internal Revenue Code provisions for which there are only limited judicial or administrative interpretations. Even a technical or inadvertent mistake could endanger our REIT status.

The determination that we qualify as a REIT requires an ongoing analysis of various factual matters and circumstances, some of which may not be within our control, regarding our organization and ownership, distributions of our income and the nature and diversification of our income and assets. The fact we hold substantially all of our assets through our operating partnership and our ongoing reliance on factual determinations, such as determinations related to the valuation of our assets, further complicates the application of the REIT requirements for us.

If we lose our REIT qualification, we will face income tax consequences that will reduce substantially our available cash for dividends and investments for each of the years involved because:

- We would be subject to federal corporate income taxation on our taxable income, including any applicable alternative minimum tax, and could be subject to increased state and local taxes;
- We would not be allowed a deduction for dividends paid to shareholders in computing our taxable income; and
- Unless we are entitled to relief under applicable statutory provisions, we could not elect to be taxed as a REIT for four taxable years following the year during which we were disqualified.

The increased taxes could reduce the value of the shares as well as cash available for dividends to shareholders and investments in additional assets. In addition, if we fail to continue to qualify as a REIT, we will not be required to pay dividends to shareholders. Our failure to continue to qualify as a REIT also could impair our ability to expand our business and to raise capital.

As a REIT, we may be subject to tax liabilities that reduce our cash flow.

Even if we continue to qualify as a REIT for federal income tax purposes, we may be subject to federal and state taxes on our income or property, including the following:

- To continue to qualify as a REIT, we must distribute annually at least 90% of our REIT taxable income (which is determined without regard to the dividends-paid deduction or net capital gains) to our shareholders. If we satisfy the distribution requirement but distribute less than 100% of our REIT taxable income, we will be subject to corporate income tax on the undistributed income. In such situation, shareholders will be treated as having received the undistributed income and having paid the tax directly, but tax-exempt shareholders, such as charities or qualified pension plans, will receive no benefit from any deemed tax payments.
- We may be subject to state and local taxes on our income or property, either directly or indirectly, because of the taxation of our operating partnership or of other entities through which we indirectly own our assets.
- If we have net income from the sale of foreclosure property we hold primarily for sale to customers in the ordinary course of business or other non-qualifying income from foreclosure property, we must pay a tax on that income at the highest corporate income tax rate.
- If we sell a property, other than foreclosure property, we hold primarily for sale to customers in the ordinary course of business, our gain will be subject to the 100% “prohibited transaction” tax.
- We will be subject to a 4% nondeductible excise tax on the amount, if any, by which the distributions we pay in any calendar year are less than the sum of 85% of our ordinary income, 95% of our capital gain net income, and 100% of our undistributed income from prior years.

We may be forced to borrow funds on a short-term basis, to sell assets or to issue securities to meet the REIT minimum distribution requirement or for working capital purposes.

To qualify as a REIT, in general, we must distribute to our shareholders at least 90% of our net taxable income each year, excluding capital gains. However, we could be required to include earnings in our net taxable income before we actually receive the related cash. If we do not have sufficient cash to make the necessary dividends to preserve our REIT status for any year or to avoid taxation, we may need to borrow funds, to sell assets or to issue additional securities even if the then-prevailing market conditions are not favorable for such actions.

To the extent dividends to our shareholders had been made in anticipation of qualifying as a REIT, we might be required to borrow funds, to sell assets or to issue additional securities to pay the applicable tax if we lose our REIT qualification and are subject to increased taxes.

In addition, we will require a minimum amount of cash to fund our daily operations. Due to the REIT distribution requirements, we may be forced to make distributions when we otherwise would use the cash to fund our working capital needs. Therefore, we may be forced to borrow funds, to sell assets or to issue additional securities at certain times for our working capital needs.

If our operating partnership does not qualify as a partnership, its income may be subject to taxation, and we would no longer qualify as a REIT.

The Internal Revenue Code classifies “publicly traded partnerships” as associations taxable as corporations (rather than as partnerships), unless substantially all of their taxable income consists of specified types of passive income. We structured our operating partnership to be classified as a partnership for federal income tax purposes. However, no assurance can be given the IRS will not challenge our position or will classify our operating partnership as a “publicly traded partnership” for federal income tax purposes. To minimize this risk, we have placed certain restrictions on the transfer and/or redemption of partnership units in the Agreement of Limited Liability Limited Partnership of our operating partnership (“LLLP Agreement”). If the IRS would assert successfully our operating partnership should be treated as a “publicly traded partnership” and substantially all of the operating partnership’s gross income did not consist of the specified types of passive income, the Internal Revenue Code would treat the operating partnership as an association taxable as a corporation. In such event, we would cease to qualify as a REIT. In addition, the imposition of a corporate tax on the operating partnership would reduce the amount of distributions the operating partnership could make to us and, in turn, reduce the amount of cash available to us to pay dividends to our shareholders.

We have transfer restrictions on our shares that may limit offers to acquire substantial amounts of the trust’s shares at a premium.

To qualify as a REIT, our shares must be beneficially owned by 100 or more persons and no more than 50% of the value of our issued and outstanding shares may be owned directly or indirectly by five or fewer individuals. Currently, our Amended Declaration of Trust prohibits transfers of our shares that would result in (1) our shares being beneficially owned by fewer than 100 persons, (2) five or fewer individuals, including natural persons, private foundations, specified employee benefit plans and trusts, and charitable trusts, owning more than 50% of our shares, applying broad attribution rules imposed by the federal income tax laws, or (3) before our shares qualify as a class of publicly-offered securities, 25% or more of our shares being owned by ERISA investors. If a shareholder acquires shares in excess of the ownership limits or in violation of the restrictions on transfer, we:

- May consider the transfer to be void ab initio.
- May not reflect the transaction on our books.
- May institute legal action to enjoin the transaction.
- May redeem such excess shares.
- Automatically transfer any excess shares to a charitable trust for the benefit of a charitable beneficiary.

If such excess shares are transferred to a trust for the benefit of a charitable beneficiary, the charitable trustee shall sell the excess shares and the shareholder will be paid the net proceeds from the sale equal to the lesser of: (1) the price paid by the shareholder or the “market price” of our shares if no value was paid or (2) the price per share received by the charitable trustee.

If shares are acquired in violation of the ownership limits or the restrictions on transfer described above:

- Transferee may lose its power to dispose of the shares; and
- Transferee may incur a loss from the sale of such shares if the fair market price decreases.

These limitations may have the effect of preventing a change of control or takeover of us by a third party, even if the change in control or takeover would be in the best interest of our shareholders.

Complying with REIT requirements may restrict our ability to operate in a way to maximize profits.

To qualify as a REIT, we must continually satisfy tests concerning, among other things, the sources of our income, the nature and diversification of our assets, the amounts we distribute to our shareholders, and the ownership of our common shares. For example, we may be required to pay dividends to our shareholders at disadvantageous times, including when we do not have readily available funds. Thus, compliance with the REIT requirements may hinder our ability to operate solely on the basis of maximizing profits.

Complying with REIT requirements may force us to forego or liquidate otherwise attractive investments which could negatively impact shareholder value.

To qualify as a REIT, at the end of each calendar quarter, at least 75% of our assets must consist of cash, cash items, government securities and qualified real estate assets. The remainder of our investments in securities (other than government securities and qualified real estate assets), in general, cannot include more than 10% of the voting securities of any one issuer or more than 10% of the value of the outstanding securities of any one issuer. In addition, no more than 5% of the value of our assets (other than government securities and qualified real estate assets) can consist of the securities of any one issuer, and no more than 25% of the value of our assets may be represented by securities of one or more taxable REIT subsidiaries. Therefore, we may be required to liquidate otherwise attractive investments or may be forced to forego attractive investments to satisfy these requirements. Such action or inaction could be adverse to our shareholder interests.

Gains from asset sales may be subject to a 100% prohibited transaction tax, which tax could reduce the trust's available assets and reduce shareholder value.

We may have to sell assets from time to time to satisfy our REIT distribution requirements and other REIT requirements or for other purposes. The IRS may posit one or more asset sales may be "prohibited transactions." If we are deemed to have engaged in a "prohibited transaction," our gain from such sale would be subject to a 100% tax. The Internal Revenue Code sets forth a safe harbor for REITs that wish to sell property without risking the imposition of the 100% tax, but we cannot assure you we will be able to qualify for the safe harbor. We will use reasonable efforts to avoid the 100% tax by (1) conducting activities that may otherwise be considered a prohibited transaction through a taxable REIT subsidiary, (2) conducting our operations in such a manner so no sale or other disposition of an asset we own, directly or through any subsidiary other than a taxable REIT subsidiary, will be treated as a prohibited transaction or (3) structuring certain sales of our assets to comply with a safe harbor available under the Internal Revenue Code. We do not intend to hold assets in a manner to cause their dispositions to be treated as "prohibited transactions," but we cannot assure you the IRS will not challenge our position, especially if we make frequent sales or sales of assets in which we have short holding periods. Payment of a 100% tax would adversely affect our results of operations.

Ordinary dividends payable by REITs generally are taxed at the higher ordinary income rate which could reduce the net cash received by shareholders as a result of an investment in the trust and may be detrimental to our ability to raise additional funds through the sale of our common shares.

The maximum U.S. federal income tax rate for "qualified dividends" payable by U.S. corporations to individual U.S. shareholders currently is 20%. In general, ordinary dividends payable by REITs to its shareholders, however, are generally not eligible for the reduced rates and generally are taxed at ordinary income rates (the maximum individual income tax rate currently is 39.6%). This result could reduce the net cash received by shareholders as a result of an investment in the trust and could be detrimental to our ability to raise additional funds through the sale of our common shares.

Changes in legislative or other actions affecting REITs may adversely affect our status as a REIT.

The rules dealing with U.S. federal income taxation are constantly under review by the legislative process, the IRS and the U.S. Treasury Department. Changes to tax laws (which changes may apply retroactively) could adversely

affect us or our shareholders. Furthermore, new legislation, regulations, administrative interpretations or court decisions could change the federal income tax laws with respect to our qualification as a REIT or the federal income tax consequences of our qualification. We cannot predict whether, when, in what forms, or with what effective dates, the laws applicable to us or our shareholders may be changed.

Our Board of Trustees may revoke our REIT election without shareholder approval, and we would no longer be required to make distributions of our net income.

Our Board of Trustees can revoke or otherwise terminate our REIT election without the approval of our shareholders if our Board determines it is not in our best interest to continue to qualify as a REIT. In such case, we would become subject to U.S. federal income tax on our taxable income, and we no longer would be required to distribute most of our net income to our shareholders, which may reduce the total return to our shareholders and affect the value of the shares.

Risks Related to Tax-Exempt Investors

Common shares may not be a suitable investment for tax-exempt investors.

There are special considerations that apply to investing in common shares on behalf of a trust, pension, profit sharing or 401(k) plans, health or welfare plans, trusts, individual retirement accounts (IRAs), or Keogh plans. If you are investing the assets of any of the above in common shares, you should satisfy yourself:

- Your investment is consistent with your fiduciary obligations under applicable law, including common law, ERISA and the Internal Revenue Code;
- Your investment is made in accordance with the documents and instruments that govern the trust, plan or IRA, including any investment policy;
- Your investment satisfies the prudence and diversification requirements of Sections 404(a)(1)(B) and 404(a)(1)(C) of ERISA and other applicable provisions of ERISA and the Internal Revenue Code;
- Your investment will not impair the liquidity of the trust, plan or IRA;
- Your investment will not produce “unrelated business taxable income” for the trust, plan or IRA;
- You will be able to value the assets of the trust, plan or IRA annually in accordance with ERISA requirements and applicable provisions of the trust, plan or IRA; and
- Your investment will not constitute a prohibited transaction under Section 406 of ERISA or Section 4975 of the Internal Revenue Code.

We have not evaluated, and will not evaluate, whether an investment in us is suitable for any particular trust, plan, or IRAs.

Under certain circumstances, tax-exempt shareholders may be subject to unrelated business taxable income, which could adversely affect such shareholders.

Neither ordinary nor capital gain distributions with respect to our common shares nor gain from the sale of our common shares, in general, should constitute unrelated business taxable income to tax-exempt shareholders. The following, however, are some exceptions to this rule:

- Under certain circumstances, part of the income and gain recognized by certain qualified employee pension trusts with respect to our common shares may be treated as unrelated business taxable income if our common shares are held predominately by qualified employee pension trusts (which we do not expect to be the case);
- Part of the income and gain recognized by a tax-exempt shareholder with respect to common shares would constitute unrelated business taxable income if the tax-exempt shareholder incurs debt to acquire the common shares; and
- Part or all of the income or gain recognized with respect to our common shares held by social clubs, voluntary employee benefit associations, supplemental unemployment benefit trusts and qualified group

legal services plans that are exempt from federal income taxation under Sections 501(c)(7), (9), (17), or (20) of the Internal Revenue Code may be treated as unrelated business taxable income.

Therefore, tax-exempt shareholders are not assured all dividends received from the trust will be tax-exempt.

Risks Related to Our Relationship with the Advisor and Its Affiliates

We depend on our Advisor for the successful operations of the REIT, and if required, we may not be able to find a suitable replacement advisor.

Our ability to achieve our investment objectives is dependent upon the successful performance of our Advisor in locating attractive acquisitions, advising on dispositions of real estate properties and other real estate related assets, advising on any financing arrangements and other administrative tasks to operate our business. If the Advisor suffers or is distracted by adverse financial, operational problems in connection with its operations unrelated to us or for any reason, it may be unable to allocate a sufficient amount of time and resources to our operations. If this occurs, our ability to achieve our investment objectives or pay dividends to our shareholders may be adversely affected. Any adversity experienced by the Advisor or problems in our relationship with the Advisor could also adversely impact the operation of our properties and, consequently, our cash flow and ability to pay dividends to shareholders.

Either we or the Advisor can terminate the Advisory Agreement upon 60 days written notice to the other party for any reason, or we can terminate the Advisory Agreement immediately for cause or material breach of the Advisory Agreement. In addition, the Board of Trustees may determine not to renew the Advisory Agreement in any year. If this occurs, we would need to find another advisor to provide us with day-to-day management services or engage employees to provide these services directly to us, which would likely be difficult to do and may be costly. There can be no assurances we would be able to find a suitable replacement advisor or suitable employees or enter into agreements for such services on acceptable terms.

The termination or replacement of the Advisor could trigger a default or repayment event under financings.

Lenders providing financing for our acquired properties may include provisions in the mortgage loan documentation that state the termination or replacement of the Advisor is an event of default or an event triggering acceleration of the repayment of the loan in full. Even though we will attempt to have such provisions excluded from the loan documents, the lenders may still require them to be included. In addition, the termination or replacement of the Advisor could trigger an event of default under any credit agreement governing a line of credit we may obtain in the future. If an event of default or repayment event occurs with respect to any of our properties, our ability to achieve our investment objectives could be materially adversely affected.

The Advisor may not be able to retain its key employees, which could adversely affect our ability to carry out our investment strategies.

We depend on the retention by the Advisor of its key officers, employees and governors. However, none of these individuals have an employment agreement with the Advisor. The loss of any or all of the services by the Advisor's key officers, employees and governors and the Advisor's inability to find, or any delay in finding, replacements with equivalent skills and experience, could adversely impact our ability to successfully carry out our investment strategies and achieve our investment objectives.

Our future success also depends on the Advisor's and its affiliates' ability to identify, hire, train and retain highly qualified real estate, managerial, financial, marketing and technical personnel to provide the services to us pursuant to the Advisory Agreement and any other written services agreement, including any property management agreements. Competition for such personnel is intense, and the Advisor or its affiliates may not be able to attract, assimilate or retain such personnel in the future. The inability to attract and retain the necessary personnel could have a material adverse effect on our business and results of operations.

Payment of fees and expenses to the Advisor reduces the cash available for dividends.

The Advisor performs services for us in connection with the selection, acquisition and disposition of our investments; the management of our assets; and certain administrative services. We pay the Advisor an annual management fee, reimbursement for operating and acquisition expenses as well as acquisition, disposition, financing and development fees. Such fees and payments reduce the amount of cash available for further investments or dividends to our shareholders. Additionally, such fees increase the risk shareholders may receive a lower price when they resell their shares than the purchase price they initially paid for their shares.

There are conflicts of interest in our relationship with the Advisor and its affiliates and several trustees, which could adversely affect our operations and business operations.

We are subject to potential conflicts of interest arising out of our relationships with the trustees, Advisor and its affiliates. Conflicts of interest may arise among a trustee or the Advisor and its respective affiliates, on the one hand, and us and our shareholders, on the other hand. As a result of these conflicts, the trustee or Advisor may favor its own interests or the interests of its affiliates over the interest of our shareholders.

Allocation of time and effort

We rely on the personnel of the Advisor and its affiliates to manage our assets and daily operations. Two of our trustees are also governors and owners of the Advisor and the primary property manager of a number of our properties, and therefore have conflicts of interest in allocating their time, services and functions among us and other real estate programs or business ventures the Advisor or its affiliates organize or serve.

Division of loyalty

Several of our officers and/or trustees serve as officers, governors and owners of one or more entities affiliated with our Advisor or trustees, including property managers, tenants of our properties and brokerage companies. As a result, these individuals owe fiduciary duties to these other entities and their investors, which may conflict with the fiduciary duties that they owe to us and our shareholders. Their loyalties to these other entities and investors could result in action or inaction detrimental to our business, which could harm implementation of our business strategy and investment and leasing opportunities.

Allocation of investment opportunities

The Advisor and its affiliates are or may become committed to the continuing management of other business ventures. Accordingly, there may be conflicts of interest between our investments and other investments or business ventures in which the Advisor and its affiliates are participants. In addition, the Advisor and its officers will advise other investment programs that invest in commercial real estate properties and real estate related assets in which we may be interested. Therefore, the Advisor could face conflicts of interest in allocating and determining which programs will have the opportunity to acquire and participate in such investments as they become available. As a result, other investment programs advised by the Advisor may compete with us with respect to certain investments we may want to acquire.

Investments owned by Advisor or its affiliates

Our Advisor identifies and selects potential investments in real estate properties and other real estate related assets in which we may be interested. Such investments could include property owned by the Advisor or its affiliates.

May profit even if investment is not profitable

The Advisor receives acquisition, disposition, management, financing, and development fees under the Advisory Agreement. The Advisor and its affiliates may also be appointed or utilized to provide other services to us and our assets and receive fees and compensation for providing such other services, such as property management fees and construction fees. Therefore, the Advisor and its affiliates may profit from real estate investments even where we lose all or a portion of our investment. In addition, the agreements and arrangements, including those relating to

compensation, between us and the Advisor and its affiliates are not the result of arm's-length negotiations and their terms may not be as favorable to us as if they had been negotiated with an unaffiliated third party.

Fees received by the parties

The Advisor is paid an annual management fee for its services based on total assets as reflected on our consolidated financial statements. The Advisor may benefit by us retaining ownership of certain investments at times when our shareholders may be better served by the sale or disposition of such investments in order to avoid a reduction in the total assets and correspondingly to the Advisor's annual management fee. In addition, the Advisor may recommend we purchase investments that increase the total assets and correspondingly the Advisor's annual management fee but that is not necessarily the most suitable investments for our portfolio. Further, the book value of the assets may include property-related debt, which could influence the amount of leverage obtained on real estate investments and other real estate related investments.

Our Advisor and its affiliates (including some of our trustees) may also be entitled to additional fees for providing other services, including property management and assistance with investment acquisition and disposition. These fees could influence our Advisor's advice to us as well as the judgment of their affiliates and our trustees performing services for us. These compensation arrangements could affect their judgment with respect to:

- the continuation, renewal or enforcement of our agreements with our Advisor and its affiliates, including the Advisory Agreement and any property management agreement;
- offerings of equity by us, which may result in property acquisitions entitling our Advisor to increased acquisition, management, financing and development fees, possibly entitling its affiliates to property management fees for new properties and possibly entitling trustees to brokerage commissions;
- property sales, which entitle our Advisor to disposition fees and possibly trustees to receive brokerage commissions;
- property acquisitions, which entitle our Advisor to acquisition, financing and development fees, possibly entitles affiliates to property management fees on new properties and possibly entitles trustees to receive brokerage commissions; and
- borrowings to acquire properties, which may increase the acquisition, financing and management fees payable to our Advisor, possibly entitles affiliates to property management fees on new properties and possibly entitles trustees to receive brokerage commissions.

Risks Related to Investments in Real Estate

Our performance could be adversely affected by the general risks involved in real estate investments.

Our results of operation and financial condition, the value of our real estate assets, and the value of an investment in us are subject to the risks normally associated with the ownership and operation of real estate properties, including, among others:

- Fluctuations in occupancy rates, rent schedules and operating expenses, which can render the sale or refinancing of a real estate investment difficult or unattractive;
- The validity and enforceability of leases, financial resources of the tenants, tenant bankruptcies, rent levels and sales levels in the local areas of the investments;
- Perceptions of the safety, convenience and attractiveness of our properties and the neighborhoods where they are located;
- Ability to provide adequate management, maintenance and insurance on our properties;
- Adverse changes in local population trends, market conditions, neighborhood values, local economic and social conditions;
- Supply and demand for properties such as our real estate investments, competition from properties that could be used in the same manner as our real estate investments;
- Changes in interest rates and availability of permanent mortgage funds;
- Changes in real estate tax rates and other taxes;

- Changes in governmental rules, regulations and fiscal policies, including the effects of inflation and enactment of unfavorable real estate, rent control, environmental or zoning laws; and
- Hazardous material laws, uninsured losses and other risks.

All of these factors are beyond our control. Any negative changes in these factors could affect our ability to meet our obligations, pay dividends to shareholders or achieve our investment objectives.

Market disruptions may significantly and adversely affect our financial condition and results of operations.

Our results of operations may be sensitive to changes in overall economic conditions impacting tenant leasing practices, such as increased unemployment, weakening of tenant financial condition, large-scale business failures and tight credit markets. Adverse economic conditions affecting tenant income, such as employment levels, business conditions, interest rates, tax rates, fuel and energy costs and other matters, could reduce overall tenant leasing or cause tenants to shift their leasing practices. In addition, periods of economic slowdown or recession, rising interest rates or declining demand for real estate, or the public perception any of these events may occur, could result in a general decline in rents or an increased incidence of defaults under existing leases. A general reduction in the level of tenant leasing could adversely affect our ability to maintain our current occupancy rates and gain new tenants, affecting our growth and profitability. Accordingly, difficult financial and macroeconomic conditions could have a significant adverse effect on our cash flows, profitability and results of operations.

Lack of geographic diversity of our real estate investments could adversely affect our operating results if economic changes impact those real estate markets.

Geographic concentration of our properties may expose us to economic downturns in those areas where our properties are located. A recession in any area where we own several properties or interests in properties could adversely affect our ability to generate or increase operating revenues, locate and retain financially sound tenants or dispose of unproductive properties. In addition, it could have an adverse impact on our tenant's revenues, costs and results of operations and may adversely affect their ability to meet their obligations to us. Likewise, we may be required to lower our rental rates to attract desirable tenants in such an environment. Currently, the majority of our properties are located in North Dakota, and we hold several properties in Fargo, North Dakota. To the extent weak economic or real estate conditions affect North Dakota or other markets in which we own properties more severely than other areas of the country, our financial performance could be negatively impacted.

We face numerous risks associated with property acquisitions which could adversely affect our operating results.

Through our operating partnership, we acquire properties and portfolios of properties. Our acquisition activities and their success are subject to the following risks typically encountered in real estate acquisitions:

- We may be unable, or decide it is not in our interests, to complete an acquisition after making a non-refundable deposit and incurring certain other acquisition-related costs or purchasing an option to purchase;
- We may be unable to obtain financing for acquisitions on favorable terms or at all;
- Acquired properties may fail to perform as expected;
- The actual costs of repositioning or redeveloping acquired properties may be greater than our estimates;
- Acquired properties may be located in new markets in which we may face risks associated with a lack of market knowledge or understanding of the local economy, lack of business relationships in the area and unfamiliarity with local governmental and permitting procedures; and
- We may be unable to quickly and efficiently integrate new acquisitions, particularly acquisitions of portfolios of properties, into our existing operations.

These risks could have an adverse effect on our results of operation, our financial condition and the amount available for payment of dividends to our shareholders.

We may invest in undeveloped real property, which requires us to pay expenses prior to receiving any income on the property.

We have the discretion to invest up to 10% of our total assets in undeveloped property. If we invest in undeveloped property, such property will not generate operating revenue while costs are incurred to develop the property and may generate other expenses including property taxes and insurance. In addition, construction may not be completed within budget or as scheduled and projected rental levels may not be achieved. In addition to the risks of real estate investments in general, an investment in undeveloped property is subject to additional risks, including the expense and delay which may be associated with rezoning the land for a higher use and the development and environmental concerns of governmental entities and/or community groups. Therefore, we will not generate income on such property until development is completed and we begin leasing the property.

We may acquire multiple properties in a single transaction, which may adversely affect our operations through the inclusion of less desirable investments or financing requirements greater than we would otherwise be willing to incur.

Periodically, we may acquire multiple properties in a single transaction. Portfolio acquisitions are more complex and expensive than single property acquisitions, and the risk a multiple property acquisition does not close may be greater than in a single property acquisition. Portfolio acquisitions may also result in us owning investments in geographically dispersed markets, placing additional demands on our ability to manage the properties in the portfolio. In addition, a seller may require a group of properties be purchased as a package even though we may not want to purchase one or more properties in the portfolio. In these situations, if we are unable to identify another person or entity to acquire the unwanted properties, we may be required to operate or attempt to dispose of these properties. To acquire multiple properties in a single transaction we may be required to accumulate a large amount of cash. We would expect the returns we can earn on such cash to be less than the ultimate returns in real property and therefore, accumulating such cash could reduce the funds available for dividends. Any of the foregoing events may increase the risk of adverse business results and negatively affect our results of operations.

We may invest in co-ventures, where our co-venture partners, co-tenants or other partners in co-ownership arrangements could take actions that decrease the value of a real estate investment and lower our overall return.

We may enter into joint ventures, tenant-in-common investments or other co-ownership arrangements with our Advisor, its affiliates, our trustees, or third parties having investment objectives similar to ours in the acquisition of real estate investments. In such arrangements, we may be acquiring non-controlling interests in or sharing responsibility for managing the affairs of the joint venture. In such event, we would not be in a position to exercise sole decision-making authority regarding the joint venture. Investments in joint ventures may, under certain circumstances, involve risks not present where another party is not involved, including the possibility partners or co-venturers might become bankrupt or fail to fund their required capital contributions. Co-venturers may have economic or other business interests or goals which are inconsistent with our business interests or goals, and may be in a position to take actions contrary to our policies or objectives.

Such investments may also have the potential risk of impasses on decisions, such as a sale, because neither we nor the co-venturer would have full control over the joint venture. Disputes between us and co-venturers may result in litigation or arbitration that would increase our expenses and prevent our management and the Advisor from focusing their time and effort on our business. Consequently, actions by or disputes with co-venturers might result in subjecting properties owned by the joint venture to additional risk. In addition, we may in certain circumstances be liable for the actions of our co-venturers. Any of these risks could subject us to liabilities in excess of those contemplated and reduce our returns on that investment.

We could experience difficulties or delays renewing leases or re-leasing space, which will increase our costs to maintain such properties without receiving income.

We derive a significant portion of our net income from rent received from our tenants. Our properties include both residential as well as commercial properties. If a tenant experiences a downturn in its business or other types of financial distress, it may be unable to make timely rental payments. If a significant number of tenants default on lease payments to us, it would cause us to lose the revenue associated with such leases and require us to find

alternative sources of revenue to meet mortgage payments and prevent a foreclosure if the property is subject to a mortgage. If lease defaults occur, we may experience delays in enforcing our rights as landlord. Also, if our tenants decide not to renew their leases, terminate early or default on their lease, we may not be able to re-let the space or may experience delays in finding suitable replacement tenants. Even if tenants decide to renew or lease new space, the terms of renewals or new leases, including the cost of required renovations or concessions to tenants, may be less favorable to us than current lease terms. As a result, our net income and ability to pay dividends to shareholders could be materially adversely affected. Further, if one of our properties cannot be leased on terms and conditions favorable to us, the property may not be marketable at a suitable price without substantial capital improvements, alterations, or at all.

We could face potential adverse effects if a commercial tenant is unable to make timely rental payments, declares bankruptcy or become insolvent.

If a tenant experiences a downturn in its business or other types of financial distress, it may be unable to make timely rental payments. Delayed rental payments could adversely affect cash flow available for dividends. If a commercial tenant declares bankruptcy or becomes insolvent, it may adversely affect the income produced by our properties. If a tenant defaults, we may experience delays and incur substantial costs in enforcing our rights as landlord. However, if a tenant files for bankruptcy, we cannot evict the tenant solely because of such bankruptcy. If a court authorizes the commercial tenant to reject and terminate its lease with us, our claim against the tenant for unpaid future rent would be subject to a statutory cap that might be substantially less than the remaining rent actually owed under the lease. In addition, it is unlikely a bankrupt tenant would pay in full amounts it owes us under a lease. Additionally, we may be required to incur additional costs in the form of tenant improvements and leasing commissions in our efforts to lease the space to a new tenant, as well as lower our rental rates to reflect any decline in market rents. This shortfall could adversely affect our cash flow and results of operations.

If our reserves for making capital improvements on our real estate investments are insufficient, we may be required to defer necessary capital improvements which could negatively affect our revenues.

We establish capital reserves on a property-by-property basis, as we deem appropriate. If we do not have enough reserves to cover the costs of capital improvements throughout the life of the real estate property and there is insufficient cash available from our operations, we may have to borrow funds or defer necessary improvements to the property. If we delay or do not make necessary capital improvements when needed, there are risks the property may decline in value and may result in fewer tenants maintaining or renewing their leases and attracting new tenants to the property. If this happens, we may not be able to maintain projected rental rates for affected properties, and our results of operations may be negatively impacted.

Properties will face significant competition for tenants, which could limit our profitability.

We face significant competition from owners, operators and developers of similar real estate properties designed and dedicated to serve tenants with the same needs as the tenants that occupy or could occupy our properties in the same market. These competitors may have greater resources than we do, and may have other advantages resulting from lower cost of capital and enhanced operating efficiencies. This competition may affect our ability to attract and retain tenants and may reduce the rents we are able to charge. These competing properties may have vacancy rates higher than our properties, which may result in their owners being willing to lease available space at lower prices than the space in our properties. Due to such competition, the terms and conditions of any lease we enter into with our tenants may vary substantially from those we anticipate when we acquire a property. Our properties experience competition from existing and planned projects, as well as newer developments located within the market area. We cannot assure competitors will not develop similar properties in the area or not be able to negotiate better leases for existing or new properties which could adversely affect the profitability and viability of our properties.

Increased affordability of single-family homes could limit our ability to retain residents, lease apartment units or increase or maintain rents.

The residential properties we own or may acquire can compete with numerous housing alternatives in attracting residents, including other apartment communities and single-family homes, as well as owner occupied single- and multi-family homes available to rent. Competitive housing in a particular area and the increasing affordability of

owner occupied single- and multi-family homes available to rent or buy caused by declining mortgage interest rates and government programs to promote home ownership could adversely affect our ability to retain our residents, lease apartment units and increase or maintain rental rates.

Investments in real estate are illiquid, and we may not be able to resell a property on terms favorable to us.

We intend to hold real estate properties until such time as our Advisor determines a sale or other disposition appears to be advantageous to achieve our investment objectives or when our shareholders approve our termination and liquidation. Because real estate investments are relatively illiquid, it could be difficult for us to promptly sell one or more of our real estate properties on favorable terms. This may be a result of economic conditions, availability of financing, interest rates and other factors beyond our control. This may limit our ability to change our portfolio promptly in response to adverse changes in the performance of any such property or economic or market trends. We cannot predict the length of time needed to find a willing purchaser and to close the sale of a property. Real estate investments by their nature are often difficult or time consuming to liquidate. In addition, federal tax laws imposing a 100% excise tax on gains from sales of certain types of property sales by a REIT (generally, property viewed as being purchased for resale, rather than investment) could limit our ability to sell properties and may affect our ability to sell properties without adversely affecting returns to our shareholders. These restrictions could adversely affect our ability to achieve our investment objectives.

Valuations and appraisals of our investments may not necessarily correspond to realizable value.

We value our real estate properties initially at cost, which we expect to represent fair value at that time. After acquisition, valuations may include appraisals of our properties periodically. The valuation methodologies used to value our real estate properties will involve subjective judgments regarding such factors as comparable sales, rental and operating expense data, the capitalization and/or discount rate and projections of future rent and expenses based on appropriate analysis. Our investments in real estate related assets will initially be valued at cost, and thereafter will be valued periodically, or in the case of liquid securities, daily, as applicable, at fair value as determined by the Advisor in good faith. Although our valuation procedures are designed to determine the accurate fair value of our assets, appraisals and valuations of our real estate properties and valuations of our investments in real estate related assets will be only estimates of fair value and therefore may not correspond to realizable value upon a sale of those assets.

Uninsured losses related to real estate investments may adversely affect our results of operation.

We purchase, and we may be required by lenders of mortgage loans or other financings to obtain, certain insurance coverage on our real estate investments. Either the property manager or the Advisor selects policy specifications and insured limits which it believes to be appropriate and adequate given the risk of loss, the cost of the coverage and industry practice. The nature of the tenants at the properties we hold may expose us and our operations to an increase in liability for personal injuries or other losses. There can be no assurance that such insurance will be sufficient to cover all liabilities. Some of our policies may be subject to limitations involving large deductibles or co-payments and policy limits which may not be sufficient to cover losses. Furthermore, insurance against certain risks, such as terrorism, flood and toxic mold, may be unavailable or available at commercially unreasonable rates or in amounts less than the full market value or replacement cost of the properties. There can be no assurance particular risks are currently insurable, will continue to be insurable on an economical basis or current levels of coverage will continue to be available. If a loss occurs that is partially or completely uninsured, we may lose all or part of our investment in a property as well as the anticipated future cash flows from such properties. In addition, if the damaged properties are subject to recourse indebtedness, we would continue to be liable for the indebtedness, even if these properties were irreparably damaged. We may also be liable for any uninsured or underinsured personal injury, death or property damage claims, which could result in decreased dividends to shareholders.

Discovery of toxic mold on our properties may adversely affect our results of operation.

Litigation and concern about indoor exposure to certain types of toxic molds have been increasing as the public becomes aware exposure to mold can cause a variety of health effects and symptoms, including allergic reactions. Toxic molds can be found almost anywhere; they can grow on virtually any organic substance, as long as moisture

and oxygen are present. There are molds that can grow on wood, paper, carpet, foods and insulation. When excessive moisture accumulates in buildings or on building materials, mold growth will often occur, particularly if the moisture problem remains undiscovered or unaddressed. It is impossible to eliminate all mold and mold spores in the indoor environment. The difficulty in discovering indoor toxic mold growth could lead to a risk of lawsuits by affected persons and the risk that the cost to remedy toxic mold could exceed the value of the property. We will attempt to acquire properties where there is no toxic mold or where there has not been any proceeding or litigation with respect to the presence of toxic mold. However, we cannot provide assurances toxic mold will not exist on any of our properties when we acquire the properties or will not subsequently develop on any of our properties.

We may acquire a property or properties “AS IS,” which increases the risk of an investment that requires us to remedy defects or costs without recourse to the prior owner.

We may acquire real estate properties “as is” with only limited representations and warranties from the property seller regarding matters affecting the condition, use and ownership of the property. As a result, if defects in the property (including any building on the property) or other matters adversely affecting the property are discovered, we may not be able to pursue a claim for any or all damage against the property seller. Such a situation could negatively affect our results of operations.

We may engage in leaseback transactions, which involve risks including a failure to qualify as a REIT.

From time to time we have purchased certain real estate properties and lease them back to the sellers of such properties. While we use our best efforts to structure any such leaseback transactions to be characterized as a “true lease” so we will be treated as the owner of the property for federal income tax purposes, we cannot assure you the IRS will not challenge such characterization. If any such re-characterization were successful, deductions for depreciation and cost recovery relating to such real property would be disallowed, interest and penalties could be assessed by the IRS and it is possible, under some circumstances, we could fail to qualify as a REIT as a result.

We rely on affiliated and outside property managers to properly manage and lease our properties.

The Advisor and an affiliate of the Advisor serve as our main property managers, and the Advisor has hired and intends to hire other affiliates and/or third parties to serve as additional property managers, to manage our properties and act as leasing agents to lease vacancies in our real estate properties. These property managers will have significant decision-making authority with respect to the management of our properties. Our ability to direct and control how our properties are managed may be limited. We will not, and the Advisor will not as to its affiliates and third party property managers, supervise any of the property managers or any of their respective personnel on a day-to-day basis. Thus, the success of our business may depend in large part on the ability of our property managers to manage the day-to-day operations and their ability to lease vacancies in our properties. Any adversity experienced by our property managers could adversely impact the operation and profitability of our properties and, consequently, our ability to achieve our investment objectives.

Risks Related with Our Indebtedness and Financing

Current market conditions could adversely affect our ability to obtain financing.

As a REIT, we are required to distribute at least 90% of our taxable income (excluding net capital gains) to our shareholders in each taxable year, and thus our ability to retain internally generated cash is limited. Accordingly, our ability to acquire properties or to make capital improvements to or remodel properties will depend on our ability to obtain debt or equity financing from third parties or the sellers of properties or to sell other properties. We have incurred mortgage debt and pledged some or all of our properties as security for debt in order to obtain funds to acquire additional properties or for working capital. We have also obtained a line of credit to provide a flexible borrowing source of funds.

Market fluctuations and disruptions in the credit markets could significantly affect our ability to access capital. Reductions in our available borrowing capacity, or inability to establish a credit facility when required or when business conditions warrant, could then limit the number, size and quality of properties we could acquire or the

amount of improvements we could make on acquired properties, which could materially affect our ability to achieve our investment objectives and may result in price or value decreases of our real estate assets.

We will incur mortgage indebtedness and other borrowings, which will increase our business risks.

We have obtained mortgage loans on many of our properties so we can use our capital to acquire additional real estate properties and make improvements on the properties. However, we may not incur indebtedness of more than 300% of our net assets, unless such excess is approved by a majority of our trustees. High debt levels will cause us to incur higher interest charges, which would result in higher debt service payments and could be accompanied by restrictive covenants. If there is a shortfall between the cash flow from a property and the cash flow needed to service mortgage debt on that property, then the amount available for dividends to shareholders may be reduced. In addition, incurring mortgage debt increases the risk of loss since defaults on indebtedness secured by a property may result in lenders initiating foreclosure actions. In that case, we could lose the property securing the loan in default, thus reducing the value of our shareholders' investment.

For tax purposes, a foreclosure on any of our properties will be treated as: (1) if the foreclosed debt is nonrecourse, a sale of the property for a purchase price equal to the outstanding balance of the debt secured by the mortgage or (2) if the foreclosed debt is recourse, a sale of the property for a purchase price equal to its fair market value and cancellation of debt income to the extent, if any, the outstanding debt balance exceeds the fair market value. If the outstanding balance of the debt secured by the mortgage exceeds our tax basis in the property, we will recognize taxable income on foreclosure, but we would not receive any cash proceeds. We may give full or partial guarantees to lenders of mortgage debt on behalf of our operating partnership, whereby we will be responsible to the lender for satisfaction of the debt if it is not paid by our operating partnership. If any mortgage contains cross-collateralization or cross-default provisions, a default on a single property could affect multiple properties. If any of our properties are foreclosed upon due to a default, our ability to pay cash dividends to our shareholders will be adversely affected.

We could face difficulties in refinancing loans involving balloon payment obligations.

Some of our mortgage loans require us to make a lump-sum or "balloon" payment at maturity. Our ability to make a balloon payment at maturity could be uncertain and may depend upon our ability to obtain additional financing, to refinance the debt or our ability to sell the particular property. If we try and refinance the debt, we may not be able to obtain terms as favorable as the original loan. Based on historical interest rates, current interest rates are low and, as a result, it is likely the interest rate that will be obtained upon refinancing in subsequent years may be higher than the original loan. If we are not able to refinance the debt, or obtain acceptable terms, we may be required to sell the mortgaged property at a time which may not permit realization of the maximum return on such property. The effect of a refinancing or sale could affect the rate of return to shareholders and the projected time of disposition of our assets.

Lenders may require restrictive covenants relating to our operations, which may adversely affect our flexibility and our ability to achieve our investment objectives.

Some of our mortgage loans impose restrictions on us that affect our distribution and operating policies, our ability to incur additional debt and our ability to resell interests in the property. Loan documents may contain covenants that limit our ability to further mortgage the property, discontinue insurance coverage, replace the Advisor or the property manager, or terminate certain operating or lease agreements related to the property. Such restrictions may limit our ability to achieve our investment objectives.

Increases in interest rates on variable rate debt incurred by us will reduce cash available for dividends.

If we incur variable rate debt, increases in interest rates would increase our interest costs, which would reduce our cash flows and our ability to pay dividends to our shareholders. In addition, if we need to repay existing debt during periods of rising interest rates, we could be required to liquidate one or more of our investments in properties at times which may not permit realization of the maximum return on such investments.

Failure to hedge effectively against interest rate changes may adversely affect our results of operations.

We have entered into two hedging transactions and may enter into additional such transactions. Hedging transactions could take a variety of forms, including interest rate swaps or cap agreements, options, futures contracts, forward rate agreements, or similar financial instruments. Any income from a hedging transaction to manage risk of interest rate, price changes, or currency fluctuations with respect to borrowings made or to be made, or ordinary obligations incurred or to be incurred by us to acquire or own real estate assets, which is clearly identified as such before the close of the day on which it was acquired, originated, or entered into, including gain from the disposition of such a transaction, will be disregarded for purposes of the 75% and the 95% gross income tests. If applicable, there also are rules for disregarding income for purposes of the 75% and the 95% gross income tests with respect to hedges of certain foreign currency risks. To the extent we enter into other types of hedging transactions, the income from those transactions likely will be treated as non-qualifying income for purposes of both the 75% and the 95% gross income tests. We intend to structure any hedging transactions in a manner that does not jeopardize our ability to qualify as a REIT.

Complying with REIT requirements may limit our ability to hedge liabilities through tax-efficient means.

The REIT provisions of the Code substantially limit our ability to hedge liabilities. Because we conduct substantially all of our operations through our operating partnership, any income from a hedging transaction entered into to manage risk of interest rate changes with respect to borrowings made or to be made to acquire or carry real estate assets will not constitute gross income to us for purposes of the 75% or 95% gross income test. To the extent our operating partnership enters into other types of hedging transactions, the income from those transactions is likely to be treated as non-qualifying income to us for purposes of the 75% and 95% gross income tests. As a result, we may be required to limit the operating partnership's use of advantageous hedging techniques or to implement hedges through certain taxable corporations. This could increase the costs of hedging activities because any taxable corporation would be subject to tax on gains or expose the operating partnership to greater risks associated with changes in interest rates than is otherwise desirable. In addition, losses of a taxable corporation will generally not be deductible by the operating partnership and will generally only be available to offset future taxable income of such corporation.

We may structure acquisitions of property in exchange for limited partnership units in our operating partnership on terms that could limit our liquidity or our flexibility.

We may acquire properties by issuing limited partnership units in our operating partnership to contributors of property. If we enter into such transactions, in order to induce the property owners to accept limited partnership units rather than cash, it may be necessary for us to provide them with additional incentives. For instance, our operating partnership's LLLP Agreement provides any holder of limited partnership units may, subject to certain conditions, request redemption of their units and we may purchase such units with our shares on a one-for-one exchange basis.

We may, however, enter into additional contractual arrangements with contributors of property under which we would agree to redeem a contributor's units for our shares or cash, at the option of the contributor, at set times. If the contributor required us to redeem units for cash pursuant to such a provision, it would limit our liquidity and thus our ability to use cash to make other investments, satisfy other obligations or pay dividends. Moreover, if we were required to redeem units for cash at a time when we did not have sufficient cash to fund the redemption, we might be required to sell one or more properties to raise funds to satisfy this obligation or seek short-term financing. Furthermore, in order to allow a contributor of a property to defer taxable gain on the contribution of property to our operating partnership, we might agree not to sell a contributed property for a defined period of time or until the contributor exchanged the contributor's units for cash or our shares. Such an agreement would prevent us from selling those properties, even if market conditions made such a sale favorable to us.

Risks Related to Investments in Real Estate Related Assets

Currently, our investment portfolio contains a nominal amount of real estate related assets. The following risk factors apply to such assets.

Investments in real estate related equity assets could involve higher risks than other investments, which could adversely affect our operations and ability to make dividend payments.

We can invest in common and preferred stock of both publicly traded and private real estate companies, including REITs, which involve a higher degree of risk than debt securities due to a variety of factors, including subordination to creditors and lack of any security. Our investments in real estate related equity securities can involve special risks relating to the particular issuer of the equity securities, including the financial condition and business outlook of the issuer. Issuers of real estate related common equity securities generally invest in real estate or real estate related assets and are subject to the inherent risks associated with real estate discussed in this report, including risks relating to rising interest rates.

The value of real estate related securities may be volatile and could cause the value of our shares to fluctuate, adversely affect our business operations and our ability to make dividend payments.

The value of real estate related securities, including those of REITs, fluctuate in response to issuer, political, market and economic developments. In the short term, equity prices can fluctuate dramatically in response to these developments. Different parts of the market and different types of equity securities can react differently to these developments and they can affect a single issuer or multiple issuers within an industry or economic sector or geographic region or the market as a whole. The real estate industry is sensitive to economic downturns. The value of securities of companies engaged in real estate activities can be affected by changes in real estate values and rental income, property taxes, interest rates and tax and regulatory requirements. In addition, the value of a REIT's equity securities can depend on the structure and amount of cash flow generated by the REIT. Fluctuations in value of our securities may cause the value of our shares to vary regardless of the performance of our real estate assets, adversely affect our business operations and our ability to pay dividends to our shareholders.

Investments in commercial mortgage-backed securities have similar risks to mortgage loans, and we could be adversely affected if the value of such investments decrease due to repayment changes or non-payment.

Commercial mortgage-backed securities are bonds which evidence interests in, or are secured by, a single commercial mortgage loan or a pool of commercial mortgage loans. Accordingly, any mortgage-backed securities we invest in will be subject to all the risks of the underlying mortgage loans, including the risks of prepayment or non-payment.

The value of commercial mortgage-backed securities may be adversely affected when repayments on underlying mortgage loans do not occur as anticipated, resulting in the extension of the security's effective maturity and the related increase in interest rate sensitivity of a longer-term instrument. The value of commercial mortgage-backed securities also may change due to shifts in the market's perception of issuers and regulatory or tax changes adversely affecting the mortgage securities markets as a whole. In addition, commercial mortgage-backed securities are subject to the credit risk associated with the performance of the underlying mortgage properties.

Commercial mortgage-backed securities are also subject to several risks created through the securitization process. Certain subordinate commercial mortgage-backed securities are paid interest only to the extent there are funds available to make payments. To the extent the collateral pool includes a large percentage of delinquent loans, there is a risk interest payments on subordinate commercial mortgage-backed securities will not be fully paid. Subordinate securities of commercial mortgage-backed securities are also subject to greater risk than more highly rated commercial mortgage-backed securities.

Investments in mortgage instruments could adversely affect our business operations if the values of the underlying properties decrease or there are repayment defaults.

For any investments we make in mortgage loans, we will be at risk of loss on those investments, including losses as a result of defaults on mortgage loans. These losses may be caused by many conditions beyond our control, including general prevailing local, national and global economic conditions; economic conditions affecting real estate values; changes in specific industry segments; tenant defaults and lease expirations; financial condition of tenants; changes in use of property; shift of business processes and functions offshore; declines in regional or local

real estate values, or rental or occupancy rates; increases in interest rates, real estate tax rates and other operating expenses; competition from comparable types of properties; and property management decisions.

If we acquire a property by foreclosure following defaults under any mortgage loan investments, we will bear a risk of loss of principal to the extent of any deficiency between the value of the collateral and the principal and accrued interest of the mortgage loan, which could have a material adverse effect on our ability to achieve our investment objectives. We do not know whether the values of the property securing any of our real estate securities investments will remain at the levels existing on the dates we initially make the related investment. If the values of the underlying properties drop, our risk will increase and the values of our interests may decrease. Further, seeking available remedies could be a time-consuming and expensive process and would increase the costs associated with holding such mortgage and reducing our cash available for shareholders.

If there are delays in liquidating defaulted mortgage loan investments, we could be required to incur additional expenses to pursue such remedies, which could adversely affect our operations.

If there are defaults under any mortgage loan investments we hold, we may not be able to foreclose on or obtain a suitable remedy with respect to such investments. Specifically, we may not be able to repossess and sell the underlying properties quickly, which could reduce the value of our investment. For example, an action to foreclose on a property securing a mortgage loan is regulated by state statutes and rules and is subject to many of the delays and expenses of lawsuits if the defendant raises defenses or counterclaims. Additionally, in the event of default by a mortgagor, these restrictions, among other things, may impede our ability to foreclose on or sell the mortgaged property or to obtain proceeds sufficient to repay all amounts due to us on the mortgage loan. Therefore, we may experience a delay in liquidating the investment and return of the funds to invest in new investments.

Investments in mezzanine loans may involve higher risks, and we may not be able to obtain full recourse if the investment becomes unsecured or the assets of the entity providing the pledge become insufficient to satisfy the loan.

We may invest in mezzanine loans taking the form of subordinated loans secured by second mortgages on the underlying real property or loans secured by a pledge of the ownership interests of either the entity owning the real property or the entity that owns the interest in the entity owning the real property. These types of investments involve a higher degree of risk than long-term senior first-lien mortgage loans secured by income producing real property because the investment may become unsecured as a result of foreclosure by the senior lender. In the event of a bankruptcy of the entity providing the pledge of its ownership interests as security, we may not have full recourse to the assets of such entity, or the assets of the entity may not be sufficient to satisfy our mezzanine loan. If a borrower defaults on our mezzanine loan or debt senior to our loan, or in the event of a borrower bankruptcy, our mezzanine loan will be satisfied only after the senior debt. As a result, we may not recover some or all of our investment. In addition, mezzanine loans may have higher loan-to-value ratios than conventional mortgage loans, resulting in less equity in the real property and increasing the risk of loss of principal.

Investments subject to interest rate risks may decline in value due to changes in the market interest rates, which could adversely affect the value of our assets.

Interest rate risk is the risk fixed income securities such as preferred and debt securities, and to a lesser extent dividend paying common stocks, will decline in value due to changes in market interest rates. When market interest rates rise, the fair value of such securities tend to decline, and vice versa.

During periods of rising interest rates, the average life of certain types of securities may be extended because of slower than expected principal payments. This may lock in a below-market interest rate, increase the security's duration and reduce the value of the security. During periods of declining interest rates, an issuer may be able to exercise an option to prepay principal earlier than scheduled. If this occurs, we may be forced to reinvest in lower yielding securities. Preferred and debt securities frequently have call features allowing the issuer to repurchase the security prior to its stated maturity. An issuer may redeem an obligation if the issuer can refinance the debt at a lower cost due to declining interest rates or an improvement in the credit standing of the issuer. These risks may reduce the value of any real estate related securities investments.

Investments in illiquid investments could adversely affect the value of our assets if we are unable to resell the investments when desired to protect ourselves from changes in market or economic conditions.

We may purchase real estate related securities in connection with privately negotiated transactions not registered under the relevant securities laws, resulting in a prohibition against their transfer, sale, pledge or other disposition except in a transaction exempt from the registration requirements of, or is otherwise in accordance with, those laws. As a result, our ability to vary our portfolio in response to changes in economic and other conditions may be relatively limited. Any mezzanine and bridge loans we may purchase will be particularly illiquid investments due to their short life, their unsuitability for securitization and the greater risk of our inability to recover loaned amounts in the event of a borrower's default.

Liquidation prior to the maturity of any real estate securities investments could require us to sell on unfavorable terms and for a lower price than anticipated if held to maturity.

Our Board of Trustees may choose to liquidate assets, including any real estate related securities investments. If we liquidate those types of investments prior to their maturity, we may be forced to sell those investments on unfavorable terms or at a loss during a time when prevailing interest rates are higher than the interest rates of such mortgage loans, whereby we would sell such investments at a discount to their stated principal values.